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IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION TWO

SEAN DORSEY and JODI DORSEY, husband and wife, for themselves and for and on behalf of all those entitled to recover for the wrongful death of KELLI DORSEY,	)	2 CA-CV 2004-0064 DEPARTMENT A DRAFT DECISION
Plaintiffs/Appellees,	)	
v.	)	
U.S. HOME OF ARIZONA CONSTRUCTION COMPANY and CATALINA MECHANICAL CONTRACTING, INC.,	)	
Defendants/Appellants.	)	

APPEAL FROM THE SUPERIOR COURT OF PIMA COUNTY

Cause No. CR-20031072

Honorable Ted B. Borek, Judge

Honorable Richard S. Fields, Judge

AFFIRMED

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1

2¶ Defendants/appellants U.S. Home of Arizona Construction Company[1] and Catalina Mechanical Contracting, Inc. (collectively, "U.S. Home" or "defendants") appeal from the trial court's denial of their motion to compel arbitration. They argue that, in denying the motion, the trial court erroneously found that the real estate purchase contract

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[1]The Dorseys' complaint also listed as a defendant U.S. Home Corporation of Arizona Construction Company, which is affiliated with U.S. Home of Arizona Construction Company.

between U.S. Home and plaintiffs/appellees Sean and Jodi Dorsey was unconscionable and that the contract violated the Dorseys' reasonable expectations. We affirm.

Factual and Procedural Background

3¶ The simple and apparently uncontested facts are that in October 1998, after visiting a model home for the first time, the Dorseys purchased their first home from U.S. Home, a residence to be newly constructed in a Tucson U.S. Home subdivision. In May 1999, after they had lived in the home for approximately eight months, their infant daughter died. In September 2001, the Dorseys discovered toxic mold in their home.

4¶ Alleging that their daughter's death had resulted from toxic mold poisoning, and that both of them had suffered personal injuries from the mold, the Dorseys sued U.S. Home and its subcontractors, Catalina Mechanical Contracting, which had installed plumbing in the house, and ANSE, Inc., which had applied the exterior stucco. The complaint alleged that U.S. Home had failed to construct the home in a reasonable and workmanlike manner, had breached the duty of reasonable care in constructing the home, and had caused the wrongful death of the Dorseys' daughter and the Dorseys' personal injuries and property damage.

5¶ U.S. Home moved to dismiss the case or, in the alternative, to stay the proceedings and compel arbitration of the matter, pointing to a provision in the purchase contract mandating mediation and arbitration of all disputes. In opposing the motion, the Dorseys argued the arbitration provision was unconscionable and violated their reasonable expectations as buyers because the purchase contract had been offered "on a take it or leave it basis" and because U.S. Home representatives had not called the provision to their attention. They also maintained that the arbitration provision was unfairly obscured within the contract, that enforcing the provision would require them to

incur substantial expenses, and that arbitration would favor U.S. Home because the required arbitrators have professional backgrounds in construction.

6¶ After a hearing, Judge Borek ruled that the purchase contract was a contract of adhesion and that it was both procedurally and substantively unconscionable. The judge denied U.S. Home's motions, concluding that:

> The agreement as a whole is very one sided in favor of defendants, for example, in the provisions on financing, buyer-selections, completion, closing, site, and warrant. What is most troublesome to this Court, however, is the lack of reciprocity in the arbitration provision which identifies a promise or a warranty made by the seller and personal injury sustained by the buyer as subject to arbitration . . . [and] the undisputed costs plaintiffs assert would result in mediation and arbitration under this agreement. . . . Moreover, this Court concludes that it cannot reasonably be expected that for a tort action such as this plaintiffs would not have the prerogative of a trial.

7¶

After the case was assigned to another judge, U.S. Home moved for reconsideration of the ruling and sought an evidentiary hearing. Over the Dorseys' objection, the court allowed the defendants to conduct additional discovery. After considering the depositions of the Dorseys, their real estate agent, and the U.S. Home representative who had sold the home, and the parties' arguments, Judge Fields denied the motion for reconsideration, concluding that U.S. Home had "not established new evidence which would justify . . . reversing the previous ruling." This appeal followed.

Unconscionability

8¶

Determining whether the trial court properly denied U.S. Home's motion to compel arbitration based on a finding that the contract was unconscionable requires us to interpret the provisions of the purchase contract, an issue of law we review de novo. *See Maxwell v. Fid. Fin. Servs., Inc.*, 184 Ariz. 82, 907 P.2d 51 (1995); *Broemmer v. Abortion Servs. of Phoenix, Ltd.*, 173 Ariz. 148, 840 P.2d 1013 (1992).We will disturb the trial court's findings of fact, however, only if they are clearly erroneous. *See Maxwell; see also Scottsdale Unified Sch. Dist. No. 48 of Maricopa County v. KPNX Broad. Co.*,191 Ariz. 297, 955 P.2d 534 (1998).

9¶ The arbitration provision reads as follows:

> **18. ARBITRATION OF DISPUTES.** The parties to this Agreement specifically agree that THIS TRANSACTION INVOLVES INTERSTATE COMMERCE AND THAT any

dispute (whether contract, warranty, tort, statutory or otherwise), including, but not limited to, (a) any and all controversies, disputes or claims arising under, or related to, this Agreement, the property, or any dealings between the Buyer and Seller (with the exception of "consumer products" as defined by the Magnuson-Moss Warranty-Federal Trade Commission Act, 15 U.S.C. §2301 et seq., and the regulations promulgated thereunder); (b) any controversy, dispute or claim arising by virtue of any representations, promises or warranties alleged to have been made by Seller or Seller's representative; and (c) any personal injury or property damage alleged to have been sustained by Buyer on the property or in the subdivision, shall first be submitted to mediation and, if not settled during mediation, shall thereafter be submitted to binding arbitration as provided by the Federal Arbitration Act (9 U.S.C. §§1 et seq.) or, if inapplicable, by similar state statute, and not by or in a court of law. All decisions respecting the arbitrability of any dispute shall be decided by the arbitrator. The arbitrator shall have the right to award reasonable attorneys' fees and expenses, including those incurred in mediation, arbitration, trial or on appeal.

The mediation shall be conducted before the American Arbitration Association ("AAA") in accordance with the AAA's Commercial or Construction Industry Mediation Rules, as appropriate. If the dispute is not fully resolved by mediation, the dispute shall be submitted to binding arbitration before the AAA in accordance with the Commercial or Construction Industry Arbitration Rules, as appropriate, and judgment upon the award rendered by the arbitrator can be entered in and enforced by any court having jurisdiction over the matter. It is understood and agreed by the parties that in the event the Homeowner's Warranty provided by Seller does not provide for binding arbitration, a claim under, or covered by, the warranty will be administered as provided in the warranty prior to submission to binding arbitration.

Unless otherwise provided by law or the Homeowner's Warranty, the cost of mediation and arbitration shall be borne equally by Seller and Buyer. Buyer and Seller specifically agree that notwithstanding anything to the contrary, the rights and obligations set forth in this paragraph shall survive (1) the closing of the purchase of the property; (2) the termination of this Agreement by either party; or (3) the default of this Agreement by either party. The waiver or invalidity of any portion of this paragraph shall not affect the validity or enforceability of the remaining portions of this paragraph. Buyer and Seller further agree (1) that any dispute involving Seller's directors, officers, employees and agents shall be resolved as set forth herein and not in a court of law; (2) that Seller shall have the option to include its subcontractors and suppliers as parties in the mediation and arbitration; and (3) that the mediation and arbitration will be limited to the disputes involving the parties specified herein, including any warranty company and insurer.

10¶ Section 12-1501, A.R.S., which governs the validity of arbitration

agreements, provides:

> A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Among the grounds for revoking a contract are procedural and substantive unconscionability, A.R.S. § 47-2302(A); *Nelson v. Rice*, 198 Ariz. 563, 12 P.3d 238 (App. 2000), and a court's determination that a contract is one of adhesion. *See Broemmer; Phoenix Baptist Hosp. & Med. Ctr., Inc. v. Aiken*, 179 Ariz. 289, 877 P.2d 1345 (App. 1994). Emphasizing the public policy favoring arbitration of disputes, *see, e.g., Broemmer*, U.S. Home challenges the trial court's findings that the contract here is both procedurally and substantively unconscionable.

a. Procedural Unconscionablility

11¶ U.S. Home first insists that the trial court used the wrong legal analysis in evaluating whether the arbitration provision was procedurally unconscionable. It argues that the court's inquiry into the Dorseys' reasonable expectations would have been more appropriate in determinating whether the contract was one of adhesion. *See Maxwell* (unconscionability analysis typically does not involve assessment of parties' reasonable expectations); *see also Southwest Pet Prods., Inc. v. Koch Indus., Inc.*, 107 F. Supp. 2d 1108 (D. Ariz. 2000) (same).[2] Of course, we may affirm the trial court on any ground

that is legally correct. *See In re Herbst Trust*, 206 Ariz. 214, 76 P.3d 888 (App. 2003).

12¶ Under Arizona law, procedural unconscionability "'is concerned with "unfair surprise," fine print clauses, mistakes or ignorance of important facts . . . [and indications that] bargaining did not proceed as it should.'" *Maxwell*, 184 Ariz. at 88-89, 907 P.2d at 57-58, *quoting* 2 Dan B. Dobbs, *Law of Remedies* § 10.7, at 706 (2d ed. 1993). An analysis of procedural unconscionability requires a court to consider the following factors:

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[2]U.S. Home insists the trial court erred in applying *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003), because that case evaluated California rather than Arizona law. In California, a finding that a contract is one of adhesion necessarily means that the contract also is procedurally unconscionable. *Ting*. Given that we do not engage in a procedural unconscionability analysis, we need not address U.S. Home's challenge to the court's analysis on that ground. However, as the trial court implicitly found, *Ting* provides valuable instruction on the viability of arbitration provisions in general, and to the extent it suggests a substantive unconscionability test similar to Arizona's, we find *Ting* useful in our analysis.

age, education, intelligence, business acumen and experience, relative bargaining power, who drafted the contract, whether the terms were explained to the weaker party, whether alterations in the printed terms were possible, whether there were alternative sources of supply for the goods in question.

Id. at 89, 907 P.2d at 58, *quoting Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264, 268 (E.D. Mich. 1976). Because it is unclear whether, under Arizona law, a finding of procedural unconscionability alone is sufficient to establish that a contract provision is unconscionable, we instead address whether the purchase contract's arbitration provision was substantively unconscionable. *Id.* at 90, 907 P.2d at 59. ("If only procedural irregularities are present, it may be more appropriate to analyze the claims under the doctrines of fraud, misrepresentation, duress, and mistake."); *In re Marriage of Pownall*, 197 Ariz. 577, 5 P.3d 911 (App. 2000).

b. Substantive Unconscionability

13¶

"Substantive unconscionability concerns the actual terms of the contract and examines the relative fairness of the obligations assumed." *Maxwell*, 184 Ariz. at 89, 907 P.2d at 58; *see also Southwest Pet.* When undertaking such an analysis, a court must consider the following factors: "contract terms so one-sided as to oppress or unfairly surprise an innocent party, an overall imbalance in the obligations and rights imposed by the bargain, and significant cost-price disparity." *Maxwell*, 184 Ariz. at 89, 907 P.2d at 58; *see also Angus Med. Co. v. Digital Equip. Corp.*, 173 Ariz. 159, 840 P.2d 1024 (App. 1992).

14¶ The trial court properly observed that the actual terms of the arbitration

provision severely limit the Dorseys' available remedies for a host of potential claims, ranging from a product liability claim to "any representations, promises or warranties" and, most notably, personal injury claims. Of particular concern here is the arbitration provision's effect of requiring the Dorseys to mediate any tort or personal injury claim, including wrongful death. *See Angus* (recognizing public policy concerns that may preclude contractual waiver of tort claims as unconscionable). Given our supreme court's observation in *Maxwell* that substantive unconscionability is particularly conspicuous "in cases involving . . . limitation of remedies," this particular limitation, in combination with the additional concerns we outline below, suggests the arbitration provision is substantively unconscionable. 184 Ariz. at 90, 907 P.2d at 59.

15¶ Examination of an alleged substantively unconscionable arbitration provision properly includes consideration of the realities and practicalities inherent in the commercial setting. In *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003), the Ninth Circuit found unconscionable a telecommunications carrier's limitation of the legal remedies available to its customers and its requirement that complaining customers split arbitration fees with the carrier. In arriving at its conclusion, the court pointedly considered the practicalities of the business setting and the relatively weaker bargaining position of an individual consumer. *Id.* The court also noted that the arbitration provision in that case "impose[d] on some consumers costs greater than those a complainant would bear if he or

she would file the same complaint in court." *Id.* at 1151.

16¶ Here, the initial cost to the Dorseys of proceeding to arbitration after first exhausting the required mediation process would be considerable. As in *Shankle v. B-G Maintenance, Inc.*, 163 F.3d 1230 (10th Cir. 1999), *cited with approval in Ting*, in which the cost of participating in arbitration was projected to range from $1,875 to $5,000, the Dorseys would be required to spend at least $3,250 simply to initiate the arbitration process. That nonrefundable fee, moreover, increases concomitantly with the value of the Dorseys' asserted claims and can reach or exceed $13,000. Added to that cost are the arbitrator's hourly fee and various other incidental charges. And, "AAA may require the parties to deposit in advance of any hearings such sums of money as it deems necessary to cover the expense of the arbitration."

17¶ The provision also requires that the arbitration proceed "in accordance with the AAA's Commercial or Construction Industry Arbitration Rules." It is apparent that the forum U.S. Home specifically chose, involving arbitration in accordance with construction industry standards before arbitrators whom, presumably, U.S. Home regularly appears, would have significantly favored it over the Dorseys. *See Ting*, 319 F.3d at 1151 ("[B]ecause companies continually arbitrate the same claims, the arbitration process tends to favor the company."); *see also Mercuro v. Superior Court*, 116 Cal. Rptr. 2d 671, 678 (Ct. App. 2002) (finding arbitration provision unconscionable in part because "repeat player effect," inherent in one party's frequent appearance before same group of arbitrators, "conveys distinct advantages over the individual" party); *cf. Broemmer* (arbitration provision in contract of adhesion drafted by defendant physician required parties to proceed before licensed medical doctor specializing in obstetrics and gynecology).

18¶ We find *Ting* analogous, particularly in light of its emphasis on the disparate positions occupied by an individual consumer and a corporate entity. In contrast, the Arizona District Court in *Southwest Pet* determined that, because both the buyer and seller were sophisticated business entities, one party's securing a limitation of

remedies clause in the sales contract did not constitute substantive unconscionability. Such clearly was not the case here, in which the Dorseys, first-time home buyers, cannot be said to have had sophistication and business acumen equal to U.S. Home's to impute to them sufficient knowledge of the arbitration provision's actual implications to protect their interests in complex contractual matters.

19¶ That the Dorseys were unfairly surprised by the limitation of remedies, the significant advantages to U.S. Home should the claim proceed to arbitration, and the exorbitant cost of arbitration is readily apparent. *See Maxwell; Angus; see also Ting; Mercuro.* Taken together, these factors lead us to agree with the trial court's conclusion that the purchase contract's arbitration provision is substantively unconscionable.

c. Severability

20¶

U.S. Home insists that, as a matter of public policy favoring arbitration of disputes, the trial court should have severed the arbitration provision's requirement that arbitration take place under the auspices of the named arbitration association and, instead, should have "accepted the defendants' offer to arbitrate in a costs-savings forum" to eliminate the cost prohibitiveness that the court found as a factor in determining unconscionability. Under § 47-2302(A), after finding as a matter of law that "the contract or any clause of the contract [was] unconscionable at the time it was made," the court could "refuse to enforce the contract, or . . . enforce the remainder of the contract without the unconscionable clause, or . . . so limit the application of any unconscionable clause as to avoid any unconscionable result." *See also* Restatement (Second) of Contracts § 208 cmt. f (1981).

21¶ The trial court was not required to sever any particular portion of the arbitration provision. Likewise, as the Dorseys note, whether a contract is unconscionable is determined by examining the contract as it existed at the time of formation. *See Maxwell; Nelson v. Rice*, 198 Ariz. 563, 12 P.3d 238 (App. 2000); *see also Southwest Pet* (court must focus on commercial setting at time of contracting). U.S. Home does not assert, and its cited authority does not support the idea that, a belated offer to arbitrate before another agency obligated the trial court, or the Dorseys, to accept the proposal. *See Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000) (arbitration agreement that is silent on fees and costs not per se unenforceable); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003) (unconscionable provisions not severable).

Reasonable Expectations Doctrine

22¶

U.S. Home also challenges the trial court's determination that the contract was one of adhesion and violated the Dorseys' reasonable expectations because, in the court's view, the Dorseys "would reasonably have no contemplation [that] they would be denied

a trial or that [the] cost of arbitration would so far exceed that of trial." As before, we review this issue de novo. *See Broemmer.*

23¶ Arizona law recognizes the reasonable expectations concept as a separate basis for invalidating contract provisions, apart from and in addition to the unconscionability doctrines. *See Maxwell; Southwest Pet; Averett v. Farmers Ins. Co. of Ariz.*, 177 Ariz. 531, 869 P.2d 505 (1994); *see also* Restatement (Second) of Contracts § 211 cmt. f (1981). Moreover, "'"even if [the contract provisions are] consistent with the reasonable expectations of the party" they are unenforceable if they are oppressive or unconscionable.'" *Maxwell*, 184 Ariz. at 88, 907 P.2d at 57, *quoting Broemmer*, 173 Ariz. at 151, 840 P.2d at 1016, *quoting Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 172-73 (Cal. 1981) (brackets in *Maxwell*).

24 ¶ An adhesion contract is typically a standardized form "offered to consumers of goods and services on essentially a 'take it or leave it' basis without affording the consumer a realistic opportunity to bargain and under such conditions that the consumer cannot obtain the desired product or services except by acquiescing in the form contract."

Broemmer, 173 Ariz. at 150, 840 P.2d at 1015, *quoting Wheeler v. St. Joseph Hosp.*, 133 Cal. Rptr. 775, 783 (Ct. App. 1976) (citations omitted); *see also Gordinier v. Aetna Cas. & Sur. Co.*, 154 Ariz. 266, 742 P.2d 277 (1987) (outlining several factors that define an adhesion contract). To conclude that a contract of adhesion is unenforceable, a court must determine either that (1) the contractual provision violated a party's reasonable expectations or (2) the provision is unconscionable. *Broemmer*; *Phoenix Baptist Hosp. & Med. Ctr., Inc. v. Aiken*, 179 Ariz. 289, 877 P.2d 1345 (App. 1994). Central to all contracts of adhesion is that they are standardized forms offered on a "'take it or leave it' basis." *Southwest Pet*, 107 F.Supp. 2d at 1112.

25¶ That the arbitration provision here contravened the Dorseys' reasonable

expectations provides an equally compelling reason to invalidate it. Under the reasonable expectations doctrine, first announced in *Darner Motor Sales, Inc. v. Universal Underwriters Insurance Co.*, 140 Ariz. 383, 394, 682 P.2d 388, 399 (1984), a party may be relieved from enforcement of "certain clauses of an agreement which he did not negotiate, probably did not read, and probably would not have understood had he read them." *See also Philadelphia Indem. Ins. Co. v. Barerra*, 200 Ariz. 9, 21 P.3d 395 (2001); *cf. Angus* (finding that party was unfairly surprised by provision reducing limitation period for contract claims).

26¶ Pat Leach, the U.S. Home representative who sold the Dorseys their home, testified that, although she did not specifically remember them, her usual practice in reviewing purchase contracts with purchasers was to paraphrase a section, pause and wait for questions, and then proceed to the next section. She stated that the Dorseys had not asked any questions about the arbitration provision. Leach did not testify that she had told the Dorseys that the provision mandating arbitration was negotiable, and U.S. Home does not assert that they were so informed. *Cf. Flores v. Transamerica HomeFirst, Inc.*, 113 Cal. Rptr. 2d 376 (Ct. App. 2001) (preprinted documents presented on "take it or leave it" basis to plaintiffs in far inferior bargaining position made contract one of adhesion); *Gordinier* (*Darner* holds drafter of contract to good faith bargaining and conscionable terms).

27¶ Although Leach testified that, had the Dorseys wanted to change any of the provisions, she would have written down their proposed terms and presented them to U.S. Home, nothing U.S. Home presented suggests those proposals would have received a favorable response or that the Dorseys had any "realistic choice" about the purchase contract's terms, particularly the arbitration provision. *Broemmer*, 173 Ariz. at 151, 840 P.2d at 1016, *quoting Wheeler*, 133 Cal. Rptr. at 783. Both Sean and Jodi stated in their affidavits that they had not believed the purchase contract terms were negotiable, and both stated they understood they could not purchase the home unless they signed the contract Leach had presented to them.

28¶ The reasonable expectations doctrine also considers the contracting parties' comparative levels of sophistication and "encompasses contracts between unsuspecting consumers in weak bargaining positions faced with daunting, standardized contracts from large companies in superior bargaining positions." *Southwest Pet*, 107 F. Supp. 2d at 1112 (declining to extend *Darner* protections to contract terms negotiated between sophisticated businesspeople); *see Darner; see also Broemmer* (contract provision requiring arbitration not within reasonable expectations of plaintiff with only high school education and not experienced in commercial matters). The Dorseys' affidavits stated that neither of them had previously purchased real estate and that they had not realized they were giving up their right to have any claims, including those for wrongful death and

personal injury, heard by a jury. Jodi had graduated from high school and had later worked for a mail order company taking telephone catalog orders, as a clerk at a technical college, as a receptionist at a financial firm, and as a courtroom clerk. Sean had completed high school and taken some college courses but did not earn a degree until 2003. Nothing in the record before us suggests that the Dorseys either were or should be considered sophisticated businesspeople, requiring us to change our analysis under the reasonable expectations doctrine. *See Broemmer; Darner; see also Southwest Pet.* In light of all these considerations, we conclude the trial court did not err in finding that the arbitration provision violated the Dorseys' reasonable expectations.

Disposition

29¶

U.S. Home's exhortations that public policy demands enforcement of the arbitration provision are insufficient to overcome the trial court's determination that, under these circumstances, the Dorseys should not be compelled to arbitrate their claims. *See Broemmer*, 173 Ariz. at 153, 840 P.2d at 1018 ("When agreements to arbitrate are freely and fairly entered, they will be welcomed and enforced. They will not, however, be exempted from the usual rules of contract law . . . ."). Because we conclude that the arbitration provision is substantively unconscionable and violated the reasonable expectations doctrine, we affirm the trial court's order denying U.S. Home's motion to

compel arbitration.